

DST SYSTEMS INC
Form 10-Q
May 07, 2013
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2013

or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission File Number 1-14036

DST Systems, Inc.	
(Exact name of registrant as specified in its charter)	
Delaware	43-1581814
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
333 West 11 th Street, Kansas City, Missouri	64105
(Address of principal executive offices)	(Zip Code)

(816) 435-1000
(Registrant's telephone number, including area code)

No Changes
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Edgar Filing: DST SYSTEMS INC - Form 10-Q

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

(do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes

☐ No ☒

Number of shares outstanding of the Company's common stock as of April 30, 2013:

Common Stock \$0.01 par value — 43,906,173

Table of Contents

DST Systems, Inc.
Form 10-Q
March 31, 2013
Table of Contents

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements (unaudited)</u>	
<u>Introductory Comments</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheet —</u> <u>March 31, 2013 and December 31, 2012</u>	<u>4</u>
<u>Condensed Consolidated Statement of Income —</u> <u>Three months ended March 31, 2013 and 2012</u>	<u>5</u>
<u>Condensed Consolidated Statement of Comprehensive Income —</u> <u>Three months ended March 31, 2013 and 2012</u>	<u>6</u>
<u>Condensed Consolidated Statement of Cash Flows —</u> <u>Three months ended March 31, 2013 and 2012</u>	<u>7</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>8</u>
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>21</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>41</u>
<u>Item 4. Controls and Procedures</u>	<u>42</u>
<u>Item 4T. Controls and Procedures</u>	<u>42</u>
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	<u>43</u>
<u>Item 1A. Risk Factors</u>	<u>43</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>49</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>50</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>50</u>
<u>Item 5. Other Information</u>	<u>50</u>
<u>Item 6. Exhibits</u>	<u>51</u>

The brand, service or product names or marks referred to in this Report are trademarks or service marks, registered or otherwise, of DST Systems, Inc. or its subsidiaries or affiliates or of vendors to the Company.

Table of Contents

DST Systems, Inc.
Form 10-Q
March 31, 2013

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Introductory Comments

The Condensed Consolidated Financial Statements of DST Systems, Inc. (“DST” or the “Company”) included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the United States Securities and Exchange Commission. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to enable a reasonable understanding of the information presented. These Condensed Consolidated Financial Statements should be read in conjunction with the Company’s audited financial statements and the notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012.

The results of operations for the three months ended March 31, 2013 are not necessarily indicative of the results to be expected for the full year 2013.

Table of Contents

DST Systems, Inc.
Condensed Consolidated Balance Sheet
(in millions, except per share amounts)
(unaudited)

	March 31, 2013	December 31, 2012
ASSETS		
Current assets		
Cash and cash equivalents	\$ 120.8	\$ 88.3
Funds held on behalf of clients	333.4	398.9
Client funding receivable	49.5	43.8
Accounts receivable	356.4	360.5
Other assets	70.4	62.8
	930.5	954.3
Investments	971.4	922.1
Unconsolidated affiliates	390.8	403.0
Properties	468.7	475.0
Intangible assets	148.9	152.7
Goodwill	422.6	422.1
Other assets	84.4	63.3
Total assets	\$ 3,417.3	\$ 3,392.5
LIABILITIES AND EQUITY		
Current liabilities		
Current portion of debt	\$ 564.5	\$ 519.4
Client funds obligations	382.9	442.7
Accounts payable	95.3	94.1
Accrued compensation and benefits	101.7	140.0
Deferred revenues and gains	78.6	67.6
Income taxes payable	30.3	9.5
Other liabilities	100.9	105.2
	1,354.2	1,378.5
Long-term debt	473.9	492.2
Income taxes payable	80.1	76.4
Deferred income taxes	300.6	296.2
Other liabilities	68.7	69.5
Total liabilities	2,277.5	2,312.8
Commitments and contingencies (Note 10)		
Stockholders' Equity		
Preferred stock, \$0.01 par; 10 million shares authorized and unissued		
Common stock, \$0.01 par; 400 million shares authorized, 95.3 million shares issued	1.0	1.0
Additional paid-in capital	203.3	234.3
Retained earnings	3,557.4	3,477.7
Treasury stock (51.2 million and 51.0 million shares, respectively), at cost	(2,912.6)	(2,890.1)
Accumulated other comprehensive income	290.7	256.8

Edgar Filing: DST SYSTEMS INC - Form 10-Q

Total stockholders' equity	1,139.8	1,079.7
Total liabilities and stockholders' equity	\$3,417.3	\$3,392.5

The accompanying notes are an integral part of these financial statements.

Table of Contents

DST Systems, Inc.
Condensed Consolidated Statement of Income
(in millions, except per share amounts)
(unaudited)

	Three Months Ended March 31,	
	2013	2012
Operating revenues	\$495.2	\$475.9
Out-of-pocket reimbursements	187.2	177.3
Total revenues	682.4	653.2
Costs and expenses	574.6	559.1
Depreciation and amortization	33.2	34.0
Income from operations	74.6	60.1
Interest expense	(9.6) (11.7
Other income, net	73.2	29.7
Equity in earnings of unconsolidated affiliates	5.6	5.3
Income before income taxes	143.8	83.4
Income taxes	50.6	28.1
Net income	\$93.2	\$55.3
Average common shares outstanding	44.3	44.5
Average diluted shares outstanding	45.6	45.2
Basic earnings per share	\$2.10	\$1.24
Diluted earnings per share	\$2.04	\$1.22
Cash dividends per share of common stock	\$0.30	\$0.40

The accompanying notes are an integral part of these financial statements.

Table of Contents

DST Systems, Inc.
 Condensed Consolidated Statement of Comprehensive Income
 (in millions)
 (unaudited)

	Three Months Ended March 31,	
	2013	2012
Net income	\$93.2	\$55.3
Other comprehensive income, net of tax and reclassifications to earnings:		
Unrealized holding gains on available-for-sale securities	37.9	47.1
Unrealized gains on cash flow hedges	0.4	0.2
Foreign currency translation adjustments	(4.4)) 0.3
Other comprehensive income	33.9	47.6
Comprehensive income	\$127.1	\$102.9

The accompanying notes are an integral part of these financial statements.

Table of Contents

DST Systems, Inc.
Condensed Consolidated Statement of Cash Flows
(in millions)
(unaudited)

	Three Months Ended March 31,	
	2013	2012
Cash flows — operating activities:		
Net income	\$93.2	\$55.3
Depreciation and amortization	33.2	34.0
Net gains on investments	(70.0)	(16.7)
Amortization of share based compensation	5.9	6.0
Equity in earnings of unconsolidated affiliates	(5.6)	(5.3)
Dividends from unconsolidated affiliates	0.2	0.2
Deferred income taxes	(1.0)	(0.5)
Changes in accounts receivable	4.0	(12.2)
Changes in other assets	(10.3)	(34.5)
Changes in accounts payable and accrued liabilities	(5.8)	26.5
Changes in income taxes payable	25.4	22.9
Changes in deferred revenues and gains	11.1	(9.8)
Changes in accrued compensation and benefits	(43.9)	(20.6)
Other, net	5.8	(2.5)
Total adjustments to net income	(51.0)	(12.5)
Net	42.2	42.8
Cash flows — investing activities:		
Capital expenditures	(27.6)	(30.7)
Proceeds from unconsolidated affiliates	3.1	0.1
Investments in securities	(31.7)	(70.6)
Proceeds from sales/maturities of investments	133.6	89.1
Net (increase) decrease in restricted cash and cash equivalents held to satisfy client funds obligations	44.8	(32.7)
Other, net	(17.8)	2.3
Net	104.4	(42.5)
Cash flows — financing activities:		
Proceeds from issuance of common stock	12.2	38.5
Principal payments on debt	(15.1)	(5.4)
Net borrowings (payments) on revolving credit facilities	40.5	(17.9)
Net increase (decrease) in client funds obligations	(65.5)	36.6
Common stock repurchased	(74.1)	(26.3)
Payment for acquisition of non-controlling interest		(17.7)
Payment of cash dividends	(13.3)	
Excess tax benefits from share based compensation	1.2	3.3
Net	(114.1)	11.1
Net increase in cash and cash equivalents	32.5	11.4
Cash and cash equivalents, beginning of period	88.3	40.9
Cash and cash equivalents, end of period	\$120.8	\$52.3

The accompanying notes are an integral part of these financial statements.

Table of Contents

DST Systems, Inc.
Notes to Condensed Consolidated Financial Statements
(unaudited)

1. Summary of Accounting Policies

The Condensed Consolidated Financial Statements of DST Systems, Inc. (“DST” or the “Company”) included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the United States Securities and Exchange Commission (“SEC”). Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to enable a reasonable understanding of the information presented. The Condensed Consolidated Balance Sheet as of December 31, 2012 has been derived from the audited Consolidated Balance Sheet at that date, but does not include all of the information and notes required by GAAP for complete financial statements. These Condensed Consolidated Financial Statements should be read in conjunction with the Company’s audited financial statements and the notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012.

In the opinion of management, the accompanying unaudited Condensed Consolidated Financial Statements contain all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the consolidated financial position of the Company and its subsidiaries at March 31, 2013, and the results of operations, comprehensive income and cash flows for the three months ended March 31, 2013 and 2012.

Certain amounts in the 2012 financial statements have been reclassified to conform to the 2013 presentation.

The results of operations for the three months ended March 31, 2013 are not necessarily indicative of the results to be expected for the full year 2013.

New Authoritative Accounting Guidance

Comprehensive Income

On January 1, 2013, DST adopted new authoritative accounting guidance that modifies the reporting of reclassifications out of accumulated other comprehensive income. The standard requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in the consolidated statement of income if the amount being reclassified is required to be reclassified in its entirety to net income. For other amounts that are not required to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference to other required disclosures that provide additional detail about those amounts. The adoption of this guidance did not have a significant effect on the consolidated financial statements.

2. Client Funds/Obligations

The Company had \$333.4 million and \$398.9 million of funds held on behalf of clients at March 31, 2013 and December 31, 2012, respectively. Included in these amounts were \$4.2 million and \$11.8 million of fixed-income marketable securities at March 31, 2013 and December 31, 2012, respectively, which have been classified as available-for-sale investments. There were no significant unrealized gains or losses associated with these fixed-income securities at March 31, 2013 and December 31, 2012. During the three months ended March 31, 2013 and 2012, the Company received \$29.7 million and \$31.3 million, respectively, of proceeds from the sales/maturities of investments in available-for-sale securities held to satisfy client funds obligations. Gross realized gains and gross realized losses associated with the sales/maturities of these available-for-sale securities held to satisfy client funds

obligations were not significant during both the three months ended March 31, 2013 and 2012.

Table of Contents

3. Investments

Investments are as follows (in millions):

	Carrying Value March 31, 2013	December 31, 2012
Available-for-sale securities:		
State Street Corporation	\$518.8	\$436.3
Other available-for-sale securities	163.1	175.2
	681.9	611.5
Other:		
Trading securities	52.6	46.8
Held-to-maturity		14.9
Cost method, private equity and other investments	236.9	248.9
	289.5	310.6
Total investments	\$971.4	